

July 2002

# CANCELED DOD APPROPRIATIONS

## Improvements Made but More Corrective Actions Are Needed



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## **Abbreviations**

ACRN	accounting classification reference number
CRS	contract reconciliation system
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
MOCAS	Mechanization of Contract Administration Services
NATO	North Atlantic Treaty Organization
NULO	negative unliquidated obligation



United States General Accounting Office  
Washington, D.C. 20548

July 31, 2002

The Honorable Jim Nussle  
Chairman, Committee on the Budget  
House of Representatives

The Honorable Stephen Horn  
Chairman  
The Honorable Janice D. Schakowsky  
Ranking Minority Member  
Subcommittee on Government  
Efficiency, Financial Management and  
Intergovernmental Relations  
Committee on Government Reform  
House of Representatives

In 1990, the Congress changed the law governing the use of appropriation accounts because it determined that controls over them were not working.<sup>1</sup> In particular, the Congress found that the Department of Defense (DOD) may have spent hundreds of millions of dollars for purposes that the Congress had not approved. The 1990 law was intended to improve congressional control by providing that, 5 years after the expiration of the period of availability of a fixed-term appropriation, the appropriation account be closed and all remaining balances canceled. After closing, the appropriation account could no longer be used for obligations or expenditures for any purpose.

Because agencies need to keep accurate records, they may, in limited circumstances, adjust accounting records pertaining to closed accounts to correct unrecorded or improperly charged disbursements. To justify such an adjustment, an agency must have sufficient documentation for each proposed adjustment to show that the

- disbursement was made when the appropriation account to be charged was available to cover the disbursement,
- agency either did not record the disbursement when it was made or charged it to the wrong appropriation account at that time, and

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<sup>1</sup>National Defense Authorization Act for Fiscal Year 1991 (Public Law 101-510, dated November 1990).

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- proposed adjustment will result in the disbursement being charged to the proper appropriation account.

During fiscal years 1997 through 2001, DOD records show that it made about \$12 billion of adjustments affecting closed appropriation accounts, including \$1.9 billion in fiscal year 2001.<sup>2</sup>

Because of the magnitude of DOD closed account adjustments, you previously asked that we review DOD's controls over closed accounts to determine if adjustments were being made in compliance with the 1990 law. In response to that request, our July 2001 testimony and companion report<sup>3</sup> pointed out that DOD had made over \$615 million of illegal and otherwise improper adjustments to closed appropriation accounts during fiscal year 2000.<sup>4</sup> As a result, you asked that we continue to review DOD's progress in addressing the problems we had identified.

Specifically, you asked that we (1) monitor DOD's efforts to correct the problems for fiscal year 2000 closed account adjustments that were identified in our prior audit, (2) determine if DOD has experienced similar problems with closed account adjustments made during fiscal year 2001, (3) determine why DOD needs to make so many adjustments to the closed accounts, and (4) identify options available to DOD or the Congress to end the practice of adjusting closed appropriation accounts. Our previous review included a detailed review of \$2.2 billion (81 percent) of the \$2.7 billion DOD reported closed appropriation account adjustments made during fiscal year 2000. DOD is now reviewing its fiscal year 2001 closed account adjustments to determine if there are problems similar to those we

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<sup>2</sup>DOD did not maintain complete information on the number of closed account adjustments made prior to January 1997, therefore, this information was not readily available and could not be verified.

<sup>3</sup>U. S. General Accounting Office, *Canceled DOD Appropriations: \$615 Million of Illegal or Otherwise Improper Adjustments*, GAO-01-994T (Washington, D.C.: July 26, 2001) and *Canceled DOD Appropriations: \$615 Million of Illegal or Otherwise Improper Adjustments*, GAO-01-697 (Washington, D.C.: July 26, 2001).

<sup>4</sup>An adjustment to a closed appropriation account is illegal if the appropriation account being charged (1) was closed before the initial disbursement was made or (2) had not yet been enacted when the initial disbursement was made. Otherwise improper adjustments occur when accounting records show that no adjustment was necessary because the initial payment was charged correctly or there is not sufficient documentation available to determine if the initial disbursement charge is incorrect and that the adjustment corrected an error.

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identified for fiscal year 2000. As agreed with your offices, for our current review, we evaluated the \$291 million of closed account adjustments for which DOD had completed its own assessments. DOD has advised us that it plans to review an additional \$1.1 billion of its reported \$1.9 billion of fiscal year 2001 closed account adjustments. Appendix I contains more detailed information on our scope and methodology. On June 11, 2002, we requested comments on a draft of this report from the Secretary of Defense or his designee. Written comments from the Defense Deputy Chief Financial Officer are reprinted in appendix II.

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## Results in Brief

DOD has started the process of correcting the illegal or otherwise improper closed account adjustments made during fiscal year 2000. However, this will require substantial effort and, according to DOD, estimates will not be complete before the end of fiscal year 2002. While DOD has reversed about \$592 million (96 percent) of the \$615 million of illegal and otherwise improper fiscal year 2000 closed account adjustments as we recommended, this is just the starting point in addressing the problem transactions we identified. In addition, in many instances, the challenge to correct the accounting after reversing these transactions is larger than the specific illegal or otherwise improper adjustments we identified. For example, a \$210 million adjustment we identified as unnecessary in the prior report was part of an overall \$590 million closed account adjustment on a contract.<sup>5</sup> To correct the \$210 million of unnecessary adjustments, DOD had to reverse the total \$590 million adjustment. As a result, DOD is uncertain what effect the reversal of the additional \$380 million adjustment will have on the accuracy of accounting records. DOD estimates that it will take 2,300 staff hours to correct the accounting records for this large contract alone and over 21,000 staff hours (10 staff years) to correct the accounting for all of the affected fiscal year 2000 transactions. The substantial time and resources it takes to sort through DOD's complex accounting processes to correct these types of errors is yet another reason why DOD has to ensure that it accurately records transactions the first time around. The \$23 million in adjustments that have not been reversed include \$15 million of unnecessary and unsupported adjustments that DOD was still reviewing and \$8 million of proper adjustments that do not need to be reversed.

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<sup>5</sup>The \$590 million adjustment for this contract is a different number than the \$592 million of reversed closed account adjustments. Only \$210 million of the adjustment is included in the \$592 million of reversed adjustments.

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DOD had upgraded its system control features by the end of fiscal year 2001 to preclude many of the wholesale adjustments that had led to the problems we identified during our prior review. Because its system enhancements were done in stages, including some near the end of fiscal year 2001, DOD continued to make large amounts of illegal and otherwise improper closed account adjustments during the year. Our review of \$291 million of fiscal year 2001 closed account adjustments that DOD had assessed at the time of our audit showed that \$172 million (59 percent) were either illegal (\$8 million) or otherwise improper (\$164 million). The remaining \$119 million of adjustments were adequately documented corrections of errors that DOD had made over the years and, therefore, were not in violation of appropriations law or otherwise improper. DOD expects to have completed its assessment of an additional \$1.1 billion of fiscal year 2001 closed account adjustments by December 2002. However, given the intensity of staff efforts to satisfactorily address these issues, it did not expect to complete the correct accounting for transactions found to be in error until September 2004, once again highlighting the seriousness of its accounting problems.

A general lack of fundamental controls and management oversight over the use of closed accounts was the primary reason DOD was making so many closed account adjustments. Upgrading system controls and management oversight to effectively implement the 1990 account closing law has substantially reduced adjustments to closed accounts—possibly by 80 percent if the experience for the first 6 months of fiscal year 2002 proves to be a reasonable baseline to gauge future results. For example, during the first 6 months of fiscal year 2002, DOD reported making \$200 million of closed account adjustments—including only \$253,000 of illegal adjustments—which was 80 percent less than the \$1 billion of reported closed account adjustments made during the same 6 months of fiscal year 2001. Therefore, we conclude that the lack of fundamental controls and management oversight had fostered the idea among DOD contracting and accounting personnel that it was acceptable to maximize the use of available funds by adjusting the accounting records to use up unspent funds in the closed accounts, regardless of the propriety of doing so. DOD officials acknowledged that this reduction of closed account adjustments was directly attributable to the implementation of controls recommended in our July 2001 report.

While DOD had reduced the amount of closed account adjustments to just \$200 million during the first 6 months of fiscal year 2002, the fact that it had to adjust the accounting records at all to correct previous errors indicates

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DOD's long-standing problems with accurately accounting for and reporting on disbursements. Viewed in the context of all its accounting records—not just closed accounts—DOD data for fiscal year 1999 showed that almost \$1 of every \$3 in contract payment transactions was for adjustments to previously recorded payments—\$51 billion of adjustments out of \$157 billion in transactions. We found that DOD contracts that contained numerous fund citations and complex payment allocation terms were more likely to have payment errors that will require adjustments because of the amount of data that must be entered into the system and the opportunities for errors. They also cause extensive and costly rework. For example, on one contract we reviewed for closed account adjustments, we noted that there were 548 different accounting classification reference numbers (ACRN).<sup>6</sup> We also found that, over the years, the contract had been modified over 150 times and had received two complete contract reconciliations to correct prior payment problems, including one reconciliation that produced 15,322 accounting adjustments. DOD now plans to complete a third reconciliation for this contract to correct about \$3 million of illegal and otherwise improper closed account adjustments we identified. It estimates that the reconciliation will take over 9,000 hours to complete.

DOD's actions to resolve its problems with closed account adjustments are beginning to produce positive short-term results. However, if DOD fails to sustain these positive results, the Congress could require DOD top management to validate and report to the Congress all closed account adjustments. Should the Congress want to further restrict DOD's closed account adjustments, legislative options are available that would eliminate or significantly reduce future closed account adjustments. These range from prohibiting all adjustments to closed accounts after an appropriation account closes, to allowing adjustments for a specific interval after the accounts close. Each option, or possible variation thereof, poses potentially positive and negative effects. For example, legislatively prohibiting any adjustments to closed accounts after the accounts close would completely eliminate future closed account adjustments. However, not allowing any adjustments to closed accounts would prohibit any corrections of known errors in accounting records that could affect DOD's

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<sup>6</sup>DOD uses a “long line of accounting” to accumulate appropriation, budget, and management information for contract payments. DOD buying activities assign a two-character code—ACRN—to each accounting line containing unique information. As payments are made against the contract, they are allotted to the applicable ACRNs.

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ability to promptly pay future invoices. For example, if the obligated but unspent balance of a closed account was erroneously reported at less than it should be, current requirements of the closed account law would prohibit paying a contractor's invoice if the amount of the invoice was more than the unspent balance in the closed account. Instead, DOD would have to defer payment until it received additional appropriations from the Congress.<sup>7</sup>

In addition to providing options to consider in eliminating or significantly reducing closed account adjustments, we are also making recommendations to the Secretary of Defense that address the need for DOD to continue to review, reverse, and correct closed account adjustments that are found to be illegal or otherwise improper. In its comments on a draft of this report, DOD agreed with our recommendations and outlined its ongoing and planned actions to identify, reverse, and correct illegal and otherwise improper closed appropriation account adjustments.

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## Reversing Illegal and Otherwise Improper Adjustments Revealed Additional Accounting Problems

Our prior report recommended that DOD immediately reverse the \$615 million of illegal and otherwise improper closed account adjustments identified in the report and determine the correct accounting for these adjustments after the reversal. Of the \$615 million of illegal and otherwise improper adjustments, DOD has agreed that \$592 million, or about 96 percent, of the adjustments should not have been made and has reversed the adjustments. However, because of DOD's long-standing accounting accuracy problems, in many cases, reversing the transactions brought to light additional accounting problems that will require detailed reviews to determine the accounting actions necessary to correct the reversed transactions. As a result, neither DOD nor we can determine how much remains to be corrected as a result of reversing the adjustments. Table 1 provides additional details on DOD's reversal of the \$615 million fiscal year 2000 illegal and otherwise improper closed account adjustments.

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<sup>7</sup>Under the law, once an account is closed, any further obligation adjustments or disbursements cannot be made from it. Thereafter, obligation adjustments and disbursements that previously would have been chargeable to the expired appropriation account may only be charged to current appropriations. However, agencies may not (1) use more than 1 percent of the current amount appropriated for the same purpose or (2) make any payment otherwise chargeable to the closed account that would cause cumulative outlays to exceed the unexpended balance remaining in the closed account.

**Table 1: Status of DOD Reversals of \$615 Million of Illegal and Otherwise Improper Closed Account Adjustments**

Problems with adjustments	Initial adjustment amount	DFAS reversed amount
Appropriation already canceled when disbursement was made	\$107.7	\$107.7
Appropriation not yet enacted when disbursement was made	38.2	38.2
No adjustment was necessary	364.0	349.2
Insufficient documentation	104.9	96.7
<b>Total</b>	<b>\$614.8</b>	<b>\$591.8</b>

For the remaining \$23 million that has not been reversed, DOD provided us with additional documentation indicating that \$8 million of the adjustments were proper and do not need to be reversed. We still consider the remaining \$15 million to be unnecessary or unsupported adjustments since DOD has not provided sufficient support to show otherwise.<sup>8</sup>

### Thirty Contracts Will Require Reaudits to Correct Accounting

The \$592 million of illegal and otherwise improper closed account adjustments discussed in our earlier report that have now been reversed involved 45 contracts. For 30 of the 45 contracts, the reversals identified additional accounting errors that must also be corrected. The 30 contracts include over \$457 million (77 percent) of the \$592 million in reversed transactions. Because of the complexity of the contracts and time it takes to conduct a complete reaudit, officials at the Defense Finance and Accounting Service's (DFAS) Columbus Center estimate that it will take over 21,000 hours to correct the accounting for the 30 contracts.

For example, for one contract we found that DFAS Columbus had made \$210 million of closed account adjustments that should not have been made because the initial disbursement was recorded against the correct ACRN on the contract. The reason given for the adjustment was that DFAS Columbus could not pay a November 1999 invoice from a contractor for

<sup>8</sup>DOD provided additional documentation for \$7 million of the \$15 million too late for us to complete an analysis for the report.

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\$685,000 because the cited ACRN on the invoice did not have sufficient funds. The inability to pay the invoice prompted DFAS to conduct an audit of the contract that resulted in over \$590 million of adjustments to closed appropriation accounts. Our earlier audit found that of the \$590 million of adjustments, \$210 million were unnecessary and should not have been made because the actual disbursements—some of which were made over 10 years earlier—had been recorded correctly. The \$210 million was part of the \$615 million of illegal or otherwise improper transactions we identified in our earlier audit.

In response to our recommendation that DOD reverse and correct the \$210 million of unnecessary adjustments, DFAS Columbus reversed all \$590 million of the closed account adjustments.<sup>9</sup> According to DFAS officials, when reversing adjustments of this size, they generally have to reverse all the transactions involved with an adjustment not just the canceled ones. After the adjustments were reversed, other errors were created that must now be researched and corrected. For example, for this one contract, the reversal of the contract's accounting records showed that 63 contract ACRNs had negative unliquidated obligations (NULO) totaling \$85.4 million.<sup>10</sup> DFAS Columbus estimates that it will take about 2,300 hours to reaudit and correct the contract.

Our earlier review of another contract found that DFAS Columbus had recorded an adjustment that illegally moved \$79 million of disbursement charges from fiscal years 1993 through 1995 research and development appropriations to charges against a canceled fiscal year 1992 research and development appropriation. According to the contract files, the adjustment was made to redistribute the disbursement charges in accordance with the "pay oldest funds first" payment terms specified in the contract. However, we found that the redistribution was illegal because it moved disbursement charges back to an appropriation account that had closed several months before the initial disbursement was made. For example, the initial \$79 million disbursement occurred in February 1999, but the adjustment

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<sup>9</sup>Our review was limited to those transactions within an adjustment that involved only closed accounts. Reversing closed account transactions may also require that proper closed and unclosed account transactions be reversed. Therefore, there may have been millions of dollars of other closed and unclosed account transactions included in the reversal, in addition to the \$590 million, for this contract and the other 29 contracts.

<sup>10</sup>NULOs occur when recorded disbursements exceed recorded obligations, indicating that expenditures may exceed amounts authorized to be disbursed against an ACRN.

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resulted in a charge against an appropriation that canceled 4 months earlier on September 30, 1998. DOD agreed that the adjustment was illegal and reversed the \$79 million. The reversal identified other accounting errors on the contract that now must be corrected. According to DFAS contract accounting records, as of April 2002, the contract had NULOs totaling over \$100 million that will need to be researched and corrected. DFAS Columbus officials estimate that a reaudit of this contract will take over 1,850 hours to complete. DOD officials told us they plan to complete all 30 reaudits to correct the fiscal year 2000 illegal and otherwise improper adjustments by September 30, 2002.

In addition to DFAS's reaudit of the contract, Air Force officials have also initiated an investigation into the circumstances surrounding the initial \$79 million illegal adjustment to determine if personnel responsible for monitoring and administering the contract acted improperly, including the possibility that the adjustments may have resulted in Antideficiency Act violations.<sup>11</sup> Air Force officials told us that they plan to complete the investigation and issue their report before the end of fiscal year 2002.

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## Illegal or Otherwise Improper Adjustments Continued during Fiscal Year 2001

We previously reported that the DFAS contract reconciliation system (CRS) and other controls necessary to ensure that adjustments to closed appropriation accounts were proper were not in place.<sup>12</sup> We noted that DOD was in the process of upgrading CRS and correcting other control problems that significantly contributed to many of the illegal or otherwise improper adjustments to closed accounts. However, because DOD did not complete many of these actions until the end of fiscal year 2001, controls were not in place to ensure that the \$1.9 billion of closed account adjustments made during fiscal year 2001 were legal and proper.

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<sup>11</sup>The Antideficiency Act provides that an officer or employee of the U.S. government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund, or enter into a contract or other obligation for payment of money before an appropriation is made. (31 U.S.C. 1341 (a).)

<sup>12</sup>CRS is an automated reconciliation system that DFAS Columbus has used since 1995 to perform contract reconciliations and to correct errors.

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## At Least \$172 Million of Fiscal Year 2001 Adjustments Were Illegal or Otherwise Improper

Our evaluation of \$291 million (15 percent) of DOD's reported \$1.9 billion fiscal year 2001 closed appropriation account adjustments found that \$172 million (59 percent) were either illegal or otherwise improper. These adjustments should not have been made because the initial disbursements (1) occurred after the appropriation being charged had already canceled, (2) occurred before the appropriation charged was enacted, or (3) were charged to the correct appropriation in the first place and no adjustment was necessary. Also included in the \$172 million of illegal or otherwise improper closed account adjustments were adjustments that were not sufficiently documented to establish that they were proper. These adjustments were considered improper because agencies must be able to provide documentation to show that the adjustments are legal and that they changed an incorrect charge to a correct one. Table 2 provides additional details on the \$172 million of adjustments that should not have been made.

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**Table 2: Fiscal Year 2001 Illegal or Otherwise Improper Adjustments**

Dollars in millions		Adjustment amount
Problems with adjustments		
Appropriation already canceled when disbursement was made		\$3.2
Appropriation not yet enacted when disbursement was made		4.7
No adjustment was necessary		82.0
Insufficient documentation		82.1
<b>Total</b>		<b>\$172.0</b>

DOD officials agreed to reverse and correct the \$172 million of illegal and otherwise improper closed account adjustments. The remaining \$119 million of the \$291 million of adjustments was for adequately documented corrections of errors that DOD had made over the years and, therefore, were not in violation of appropriations law or otherwise improper.

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## DOD to Review Additional \$1.1 Billion of Fiscal Year 2001 Closed Account Adjustments

DOD officials told us they plan to review another \$1.1 billion of fiscal year 2001 closed account adjustments in addition to the \$291 million of closed account adjustments that we already reviewed. According to the officials, the additional \$1.1 billion of adjustments were selected based on various factors including large dollar amounts or indications that the adjustments

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may be illegal. The officials noted that completion of the review of additional adjustments would result in detailed reviews of \$1.4 billion (about 74 percent) of the total \$1.9 billion of the closed account adjustments made during fiscal year 2001. According to the officials, they estimate that the additional reviews will involve several hundred contracts and about 1,000 closed account adjustments. They plan to have the additional reviews and reversals of any illegal or otherwise improper adjustments completed by December 31, 2002. However, the officials told us that because there are so many contracts that may have to be reaudited to correct the accounting, they do not plan to have the reaudits and corrections for fiscal year 2001 closed account adjustments completed until September 2004.

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## Contract Reconciliation Controls Reduce Fiscal Year 2002 Closed Account Adjustments

In our July 2001 testimony and report, we pointed out that DOD did not have adequate systems, controls, and managerial attention to ensure that the \$2.7 billion of fiscal year 2000 adjustments affecting closed appropriation accounts were legal and otherwise proper. Our review disclosed that CRS routinely processed billions of dollars of closed appropriation account adjustments without regard to the requirements of the 1990 account closing law. Further compounding this system deficiency was the lack of DOD oversight on how contract modifications were written and processed, which changed the payment terms of some contracts to improperly make available current and expired funds. As discussed earlier, our follow-on review of fiscal year 2001 closed account adjustments found little improvement over fiscal year 2000. As a result, DOD still could not ensure that closed account adjustments made during fiscal year 2001 were legal and otherwise proper. However, once the controls were fully implemented at the beginning of fiscal year 2002, we found that the first 6 months of fiscal year 2002 closed account adjustments dropped by about 80 percent to \$200 million when compared with the same 6 months during fiscal year 2001.

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## DFAS Implements CRS Controls at End of Fiscal Year 2001

In May 2001, DOD began implementing CRS controls to identify and prevent illegal backward adjustments. This control compares the actual disbursement date with the appropriation involved in the adjustment to ensure that the adjustment does not result in moving disbursement charges back to an appropriation that had been canceled before the actual disbursement was made. In September 2001, DFAS upgraded CRS to identify and prevent illegal adjustments from moving disbursement charges

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forward to an appropriation that had not yet been enacted at the time the initial disbursement was made.

In addition to upgrading CRS to identify and prevent illegal closed account adjustments, DOD also changed the CRS default reallocation of adjusting payments from oldest funds first to proration. Under the oldest funds first reallocation method, CRS would change disbursements charged to current and expired appropriation accounts to charges against older appropriation accounts even if the initial disbursement charges were correct. Because the DFAS contract payment system, commonly known as MOCAS (Mechanization of Contract Administration Services), prorated payments across various fund cites in the contract if no payment terms were specified in the contract, this change was intended to reduce errors by making both MOCAS and CRS payment allocation defaults the same.

Previously, problems with payment reallocations arose during contract reconciliation when payments that MOCAS had initially allocated across various ACRNs on a pro rata basis were redistributed by CRS across ACRNs on an oldest funds first basis. When this occurred, the CRS payment redistributions would differ substantially from how MOCAS had originally applied the payments. As our previous audit showed, these situations created significant problems by moving payment charges from correct ACRNs to incorrect ACRNs on the contract. For example, in one case, DOD initiated a contract reconciliation because there were insufficient funds remaining on an ACRN to pay a \$685,000 contractor invoice, and this redistribution process resulted in moving \$210 million of correct payment charges to incorrect ACRNs. According to DFAS Columbus officials, supervisory personnel must now approve any deviation from the CRS default program before CRS controls can be overridden to reallocate disbursements in a manner other than proration.

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### Upgraded Controls Help Reduce Amount of Closed Account Adjustments

DOD's reported closed account adjustments during the first 6 months of fiscal year 2002 totaled about \$200 million, or about 80 percent less than the over \$1 billion of closed account adjustments DOD reportedly made during the same 6-month period of fiscal year 2001. According to DFAS officials, they believe that the significant decline in closed account adjustments is a direct result of increased DOD management and employee emphasis on resolving the problems identified in our earlier report that contributed to illegal and otherwise improper closed account adjustments.

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While DFAS's controls had greatly reduced closed account adjustments during the first 6 months of fiscal year 2002, our analysis of closed account transactions found that \$253,212 of illegal closed account adjustments had been processed from October 1, 2001, through March 31, 2002. These illegal adjustments moved disbursement charges back to appropriations that had canceled before the initial disbursements occurred. We found these adjustments had processed through a DFAS Columbus computer terminal that did not properly identify and prevent these types of illegal adjustments. DFAS officials could not explain why the computer terminal was not operating properly but took immediate action to upgrade it with the appropriate controls. The officials agreed to reverse and correct the \$253,212 of illegal adjustments. Our analysis of subsequent closed account adjustments reported after the upgrade did not identify any additional illegal closed account adjustments.

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## Numerous ACRNs and Payment Allocation Changes Cause Errors

Our earlier testimony and report pointed out that DOD's illegal and otherwise improper closed account adjustments resulted from the lack of basic controls and managerial attention required to properly account for its disbursements consistent with the 1990 account closing law. We also noted that DOD had been aware since 1996 that one of its major systems allowed for disbursements to be charged in a way that was inconsistent with the law, but had done nothing to fix the problem. This lack of fundamental controls and management oversight fostered an atmosphere in which responsible DOD contracting and accounting personnel took it for granted that it was an acceptable practice to adjust the accounting records to use unspent canceled funds on a contract in order to maximize the use of appropriated funds—a process that we concluded, and DOD agreed, was illegal. We stated that DOD would need to effect changes to its systems, policies, procedures, and the overall weak control environment that fostered the \$615 million of illegal and otherwise improper adjustments made during fiscal year 2000. To do this, we pointed out that DOD top management must clearly demonstrate its commitment to adhering to the account closing law and eliminate the abuses of appropriations law.

The 80 percent reduction of closed account adjustments during the first 6 months of fiscal year 2002 is an indication that, in the short term, DOD policies, procedures, and management commitment aimed at reducing the amount of illegal and otherwise improper closed account adjustments are having the desired effect. However, DOD's inability to accurately account for and report on disbursements overall are long-term, major problems that are pervasive and complex in nature. For example, for fiscal year 1999,

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DFAS data showed that almost \$1 of every \$3 in contract payment transactions was for adjustments to previously recorded payments—\$51 billion of adjustments out of \$157 billion in transactions. Some of the key causes of these adjustments—for both closed and unclosed accounts—relate to the complex accounting for contracts along with frequent changes in payment allocation terms.

Over the years, we have issued numerous reports discussing DOD's financial management problems, and we have designated DOD financial management as a high-risk area since 1995. The following discussion on DOD's use of ACRNs and changes in contract payment allocations is illustrative of the convoluted process that contributes to the need to adjust accounting records to correct errors.

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#### Contracts Contain Numerous ACRNs

Contracts can be assigned anywhere from 1 to over 1,000 ACRNs to accumulate appropriation, budget, and management information. Our review of fiscal years 2000 and 2001 closed account adjustments found that, in many cases, the contracts had large numbers of ACRNs. According to DFAS Columbus officials, numerous ACRNs and changes in payment allocations create payment problems by increasing the amount of data that must be entered and opportunities for errors. These problems also lead to costly and extensive contract reconciliations. For example, our review of fiscal year 2001 closed account adjustments on a Navy contract valued at about \$38 million found that the contract contained 548 ACRNs and had been modified over 150 times. Also, according to DFAS Columbus' reconciliation staff, the contract had received two reconciliations, one of which in 1998 produced 15,322 accounting adjustments. In total, we found about \$3 million of fiscal year 2001 closed account adjustments for this contract were not adequately supported and, thus, should not have been made. In discussing the contract's improper closed account adjustments with DFAS Columbus officials, they agreed that the adjustments were not proper and agreed to reverse and correct them. Because of the large number of ACRNs and contract modifications involved, they estimate that it will take over 9,000 hours to complete the contract audit.

Our combined review of the 101 contracts included in our detailed review of fiscal years 2000 and 2001 closed account adjustments found that there were 7,440 ACRNs on the 101 contracts—an average of about 74 ACRNs per contract. As table 3 shows, 38 of the 101 contracts (38 percent) had 51 or more ACRNs.

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**Table 3: Number of ACRNs per Contract**

<b>Number of ACRNs per contract</b>	<b>Number of contracts</b>	<b>Total number of contract ACRNs</b>	<b>Percentage of total number of ACRNs</b>
1 to 25	38	446	6
26 to 50	25	933	12
51 to 100	19	1,346	18
101 to 250	13	2,211	30
251 to 548	6	2,504	34
<b>Total</b>	<b>101</b>	<b>7,440</b>	<b>100</b>

We did not determine for each of these contracts why and for what purpose the numerous ACRNs were being used. However, it is clear that simplified contract accounting will be a key element to reform DOD's financial management. For example, as we pointed out in our July 2001 report, even a simple purchase could cause extensive and costly rework if assigned numerous ACRNs. We noted that a \$1,209 Navy contract for children's toys, candy, and holiday decorations for a child care center was written with most line items (e.g., bubble gum, tootsie rolls, and balloons) assigned separate ACRNs. A separate requisition number was generated for each item ordered, and a separate ACRN was assigned for each requisition. In total, the contract was assigned 46 ACRNs to account for contract obligations against a single appropriation. To record this payment against the one appropriation DFAS Columbus had to manually allocate the payment to all 46 ACRNs.

In addition, the contract was modified three times—twice to correct funding data and once to delete (deobligate) the funding on the contract for out-of-stock items. The modification deleting funding did not cite all the affected ACRNs. DFAS Columbus made errors in both entering and allocating payment data, compounding errors made in the modification. Consequently, DFAS Columbus allocated payment for the toy jewelry line item to fruit chew, jump rope, and jack set ACRNs—all of which should have been deleted by modification. Contract delivery was completed in March 1995, but payment was delayed until October 1995. DFAS Columbus officials acknowledged that this payment consumed an excessive amount of time and effort when compared to the time to process a payment charged to only one ACRN. A single ACRN would also have significantly reduced the amount of data entered into the system and the opportunities for errors.

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## Change in Contract Payment Allocation Terms

Further compounding the problem of numerous ACRNs are changes in how payments are to be allocated across various ACRNs on a contract. For example, our review of an Air Force contract that had 50 ACRNs contained about \$126 million of closed account adjustments of which we found that about \$100 million (79 percent) were illegal or otherwise improper. Further, the contract had been modified 292 times for various reasons, including changes to how payments were to be allocated across the various ACRNs. For example, the following instructions were included in contract modifications to specify payment instructions for special ACRN XB—one of several special ACRNs on the contract.<sup>13</sup>

- Contract modification 94 dated October 22, 1993, stated that, “During FY90 pay FY90 funds first until exhausted and during FY91 pay FY91 funds first until exhausted. After these funds are exhausted, pay from the oldest ACRNs first.”
- Two years later, contract modification 126 added additional payment terms for special ACRN XB as follows: “During FY90 pay FY90 funds first until exhausted and during FY91 pay FY91 funds first until exhausted. During FY94 pay FY88 funds first until exhausted. After these funds are exhausted, pay from oldest ACRNs first.”
- In June 2000, modification 160 provided more payment instructions for special ACRN XB. The modification noted that special ACRN XB consisted of funds from both the United States and North Atlantic Treaty Organization (NATO). The payment instructions specified that payments were to be made using the oldest U.S. funds before using NATO funds.

According to a July 2000 Air Force memorandum from the Air Force Materiel Command’s Deputy Director of Contracting, the special ACRNs were not to be added to any existing contracts or used in new contracts. The Deputy Director noted that the Air Force still had over 1,300 special ACRNs in the system related to the older contracts, and that there was evidence that special ACRNs were still being created or used for new contract line items or subcontract line items. In discussing this

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<sup>13</sup>The term special ACRN was used by the Air Force to establish multiple funding of contract items. It provided payment instructions necessary to allocate payments across other ACRNs as disbursements were made. For example, special ACRN XB consisted of nine ACRNs with total funding of \$145.8 million.

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memorandum with responsible Air Force contracting officials, we were told that the Air Force no longer uses special ACRNs and that once all the contracts that currently contain special ACRNs are closed out, errors or other accounting problems caused by this type of contract funding should no longer be a problem.

DFAS Columbus officials acknowledged that the combination of numerous ACRNs and modifications that change contract payment allocation terms makes it difficult to maintain accurate payment records. They agreed that the \$100 million of illegal and otherwise improper closed account adjustments for the Air Force contract discussed above should not have been made. They told us they plan to reverse and correct the illegal and otherwise improper closed account adjustments on the contract as part of their overall effort to correct fiscal year 2001 closed account adjustments. Because of the numerous ACRNs and contract modifications on the contract, DOD estimates that it will take over 1,500 hours to completely correct the accounting for this contract.

In discussing the issues of payment errors caused by numerous ACRNs and changing contract payment allocation terms, military service contracting officials agreed that in the past their contracts contained numerous ACRNs and modifications to change payment allocations. They told us that during the last 2 or 3 years, they have started to write contracts to include more specific payment allocation terms, which should make it much easier for DFAS Columbus to pay contractors without making errors that require subsequent adjustments. Further, on October 1, 2001, the Under Secretary of Defense for Acquisition, Technology, and Logistics issued a memorandum in response to our recommendation that he issue a policy to prohibit the writing of contract modifications to change the payment terms of a contract if the change would result in illegal or otherwise improper adjustments. The memorandum instructed the military service secretaries and defense agency directors to make certain that all contracting activities have procedures in place that ensure compliance with the department's financial management policies, which currently preclude the improper adjustments we identified in our report. It also required all contract modifications that include adjustments to closed appropriation accounts to be supported with contract file documentation sufficient to establish that the adjustments are legal and proper and received supervisory review. It further required that contract modifications involving closed accounts be approved in writing by the appropriate level comptroller or financial resource manager.

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DFAS Columbus officials acknowledged that the change in contract writing policies and procedures should result in fewer payment errors and adjustments. While we agree that the changes in contract writing procedures and additional policy requirements should help to reduce errors that require subsequent correcting, we found that there are still thousands of older contracts in MOCAS that have one or more closed accounts that will need to be monitored closely to ensure that illegal or otherwise improper adjustments do not occur. For example, at our request, DFAS Columbus analyzed the MOCAS database to identify contracts for which at least one of the appropriations was canceled. The results of the MOCAS inquiry showed that as of April 2002, there were 15,421 active contracts valued at \$519 billion for which at least one appropriation had been canceled. DFAS officials told us that these older contracts may contain errors that will not be discovered until a contract is completed and final contract reconciliation is performed.

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## Options Available That Will Reduce or Eliminate Closed Account Adjustments

As we have indicated, since we began our closed account work, and especially since our testimony and report on this issue in July 2001, DOD has taken actions to eliminate illegal or otherwise improper adjustments involving closed account records. As noted earlier in this report, these actions are beginning to produce positive short-term results while efforts to address the long-term problems are still ongoing. At the same time, given the severity of the existing problems and the long-term nature of DOD's transformation efforts, you asked us to identify options the Congress could consider, including prohibiting some or all adjustments to closed accounts. We basically see two options—do nothing at this time or prohibit any adjustments immediately or shortly after an appropriation account is closed. These options are discussed in the context of our closed account work at DOD. However, options that change the account closing law would also apply to all federal agencies unless the Congress specifically limited them to DOD.

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### The “No Legislative Action” Option

One option is to take no legislative action at this time and to continue to allow DOD to adjust closed account records when appropriate to correct accounting errors. This would mean that DOD could make adjustments to closed account records when there is sufficient documentation to show that the (1) disbursement was made when the appropriation account to be charged was available to cover the disbursement, (2) agency either did not record the disbursement when it was made or charged it to the wrong

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appropriation account at the time, and (3) proposed adjustment will result in the disbursement being charged to the proper appropriation account. Given that DOD's implementation of controls to identify and prevent illegal and otherwise improper adjustments seem to be having a positive effect based on 6 months of analysis, the Congress could postpone any decision to change the law in order to allow DOD additional time to monitor how its implementation of controls, policies, and procedures needed to eliminate illegal and otherwise improper closed account adjustments is working. However, given DOD's weak overall control environment, unless DOD's internal controls and management commitment to this problem are sustained, new ways may be developed to circumvent the controls recently put into place. Thus, there is a risk that, over time, illegal or otherwise improper closed account adjustments could reoccur.

If the Congress finds in the future that DOD top management does not sustain its commitment to address its overall disbursement problems, the Congress could require a combination of oversight and reporting by DOD as to the validity of any closed account adjustments.

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#### Prohibit Adjustments after Appropriation Account Closes

The second option is to amend the account closing law to prohibit any adjustments to an appropriation account after it is closed. Under this option, accounting records of an appropriation account would be final when the account was closed. This option would eliminate adjustments to closed accounts as well as the substantial time and expense associated with making them. It would also provide an additional incentive for DOD to keep better records during the time the account is open since there would be no opportunity to correct the records once the account was closed.

At the same time, this change would mean that known errors in accounting records could not be corrected once the account was closed and therefore accounting records would be permanently inaccurate. These inaccurate records could also affect DOD's ability to promptly pay for goods and services. For example, assume that because of accounting errors associated with a closed appropriation account, the unspent balance of a currently available account was reduced to less than the amount needed to

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make a subsequent payment. If DOD could not correct the error, it would not be able to make the current payment.<sup>14</sup>

In another example, assume that because of accounting errors, the balance of a closed account was less than the amount needed to pay an obligation that had been charged to the closed account when it was open. Current law allows the payment to be made from current funds if the closed account balance exceeds the amount of the payment. Prohibiting all adjustments to closed accounts would make permanent the erroneously reduced balance and therefore the payment could not be made with current funds. In each of these examples, DOD would be unable to pay for the goods or services without obtaining an additional appropriation or other form of legislative relief, which could cause a hardship for the contractor.

The Congress could also provide a variation of this option by allowing DOD a limited period, such as 6 months or 1 year, after an account is closed to adjust the accounting records for known errors. This option would provide for finality of records, but only after DOD has some additional opportunity to correct errors it detects immediately after the account is closed. This legislation, while not totally eliminating closed account adjustments, would provide some of the benefits discussed above while increasing the likelihood that DOD records relating to the closed account are more accurate. However, this option also presents some of the same payment and fund availability limitations discussed above.

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## Conclusion

DOD has made significant improvements to its controls to identify and prevent illegal and otherwise improper closed account adjustments as evidenced by the 80 percent reduction of closed account adjustments during the first 6 months of fiscal year 2002. These short-term efforts serve as an example of what can be achieved when DOD takes prompt action to correct known problems through a strong top management commitment.

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<sup>14</sup>The Congress has provided DOD with legislative relief in recent appropriation acts. For example, section 8079 of the fiscal year 2002 DOD appropriations act, Public Law No. 107-117, 115 Stat. 2265, provides that for an expired or closed account that has a negative unliquidated or unexpended balance, obligations or adjustments to obligations that would have been chargeable to the account before it expired or was closed (except for amount), and which are not otherwise chargeable to any other current account, may be charged to any current account available for the same purpose in an amount not to exceed 1 percent of the total appropriation for the current account. As a result, DOD may use current funds even when an expired or closed account has an inadequate balance to cover the payment.

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At the same time, closed account adjustments are only a small fraction of the overall disbursement adjustments DOD makes each year as a result of its long-standing financial accounting and management problems. There are no quick fixes to the underlying problems, which must be dealt with over the long term. Nevertheless, there are some additional short-term actions that can be taken by focusing on simplifying accounting and contract payment allocation terms. Modernizing financial management systems, and improving the systems adherence to basic accounting requirements, will ultimately be key to DOD effectively resolving its financial management and contract payment problems. This will require a sustained commitment by DOD's top management team over a number of years.

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## Recommendations for Executive Action

We recommend that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to direct the Director of the Defense Finance and Accounting Service to

- help ensure that DFAS Columbus completes its review and correction of the remaining fiscal year 2000 illegal and otherwise improper adjustments,
- reverse closed account adjustments made during fiscal year 2001 identified in this report as illegal or otherwise improper,
- determine the entries necessary to correct the accounting for reversed fiscal year 2001 transactions,
- help ensure that DFAS Columbus completes the review and correction of the additional \$1.1 billion of fiscal year 2001 adjustments it has scheduled for detailed review, and
- continue with DFAS's top-level management attention and monitoring of the program for future adjustments to closed appropriation accounts.

We also recommend that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to continue to monitor these adjustments so that any potential Antideficiency Act violations that may occur are promptly investigated and reported as required by the Antideficiency Act, 31 U.S.C. 1351, and implementing guidance.

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## Agency Comments and Our Evaluation

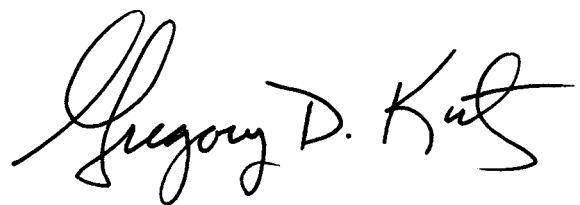
DOD agreed with our recommendations and outlined its ongoing and planned actions to identify, reverse, and correct illegal and otherwise improper fiscal year 2000 and 2001 closed appropriation account adjustments. DOD pointed out that this process may create adverse accounting conditions for a large number of contracts that will require either complete or partial reaudit to determine the correct accounting necessary to resolve the illegal or otherwise improper closed account adjustments we identified. For example, as we noted in our report, for one contract where DOD made a total of \$590 million of closed account adjustments, we found that \$210 million of the \$590 million of adjustments were unnecessary and should not have been made because the actual disbursements had been recorded correctly. In order to reverse and correct the \$210 million of unnecessary adjustments, DOD had to reverse the total \$590 million in adjustments, which created other accounting errors that must now be researched and corrected. As our report noted, DOD estimates that it will take about 2,300 hours to resolve all the errors necessary to correct the \$210 million of unnecessary adjustments we identified for this contract. DOD said it planned to have all its reaudits and corrective actions completed by September 30, 2004. DOD's comments are reprinted in appendix II.

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We are sending copies of the report to interested congressional committees. We are also sending copies of this report to the Secretary of Defense; the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics; the Secretaries of the Army, Navy, and Air Force; the Director of the Defense Finance and Accounting Service; the Secretary of the Treasury; and the Director of the Office of Management and Budget. We will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>. If you or your staffs have any questions regarding this report, please contact me at (202) 512-9505 or [kutzg@gao.gov](mailto:kutzg@gao.gov), or Larry W.

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Logsdon, Assistant Director, at (703) 695-7510 or [logsdonl@gao.gov](mailto:logsdonl@gao.gov). Major contributors to this report are acknowledged in appendix III.

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is fluid and cursive, with "Gregory" on the top line and "D. Kutz" on the bottom line.

Gregory D. Kutz  
Director, Financial Management and Assurance

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# Scope and Methodology

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To meet our first objective of monitoring DOD's efforts to correct the problems we identified in our prior audit, we reviewed DFAS officials' corrective actions taken on 162 adjustments that we previously reported as \$615 million of illegal or otherwise improper adjustments. As part of this review, we gathered vouchers that documented the reversal of the adjustments and analyzed financial information from DFAS Columbus' records and reports, including contracts, contract modifications, shipping notices, invoices, payment vouchers, and schedules of adjustments. We identified and met with the DFAS Columbus officials knowledgeable about each reversed adjustment. We also identified the responsible DFAS or military service locations that maintained the official account records and obtained documentation to show how adjustments were reversed or corrected in the accounting records.

To meet our second objective of determining if DOD experienced problems with adjustments to closed appropriation accounts in 2001 similar to the problems with the 2000 adjustments, we monitored DFAS Columbus' review of \$291 million of the \$1.9 billion of closed account adjustments DOD reportedly made during fiscal year 2001. DFAS Columbus had already selected the \$291 million of closed account adjustments for review at the time we began our audit. We took this approach rather than selecting a large number of adjustments for our own independent review because we knew that DOD had not fully implemented the controls necessary to identify and prevent fiscal year 2001 illegal and otherwise improper closed account adjustments. We reviewed the results of DFAS Columbus' efforts and worked with staff members responsible for conducting the reviews to resolve any disagreements between DFAS and GAO on whether the documentation showed that the adjustments were legal and proper. As part of our analysis of DFAS Columbus' reviews, we analyzed documentation supporting DFAS's detailed summaries for each adjustment to determine the reason for the adjustment and whether it was valid. For each adjustment, we reviewed the contract files for supporting hard copy documentation including modifications, invoices, payment vouchers, and MOCAS print screens. We also identified and met with the DFAS Columbus staff members who completed the reviews to discuss the reasons for the adjustments and resolve any differences of opinion between DFAS's and our conclusions on whether the adjustments were legal and proper.

To determine if DOD had implemented the effective system controls, which we identified in our prior report, to its contract reconciliation system to prevent illegal adjustments, we tested the CRS for two types of potentially illegal adjustments during a 6-month period. To do this, we independently

analyzed the closed account adjustments included in the CRS database for the first 6 months of fiscal year 2002 to ascertain if CRS had processed any closed account adjustments that resulted in moving a disbursement charge (1) back to an appropriation that was canceled before the actual disbursement was made or (2) forward to an appropriation that had not yet been enacted at the time the actual disbursement was made. We met with responsible DFAS Columbus officials to discuss and resolve any transactions that our analysis identified as violations of either of these two measurements. In instances where there were violations, we met with DFAS Columbus personnel to determine why CRS controls had not prevented the transactions from processing and worked with DFAS's staff to correct the system deficiencies. We did not validate the accuracy of the CRS database information pertaining to the disbursement dates or appropriations.

To meet our third objective of determining why DOD makes so many adjustments to closed accounts, we reviewed the reconciliation summaries for the fiscal years 2000 and 2001 closed account adjustments that we reviewed in detail. We also met with the DFAS Columbus staff members who performed reconciliations to obtain their opinions on the primary reasons why errors occur. However, we did not determine the specific reasons why certain contracts have numerous ACRNs or how the detailed cost information was to be used.

Finally, to determine options available to DOD and actions for the Congress to consider that would eliminate or reduce adjustments to closed appropriation accounts, we developed and presented options based on our reviews of fiscal year 2000 and 2001 closed account adjustments and discussions with DOD accounting and procurement officials.

We performed our work primarily at the DFAS Center in Columbus, Ohio. We also obtained documentation from the following DFAS locations that were responsible for maintaining official accounting records: Cleveland, and Dayton, Ohio; Denver, Colorado; San Bernardino, California; and St. Louis, Missouri. Our review was conducted from June 2001 through April 2002 in accordance with U.S. generally accepted government auditing standards, except that we did not validate the accuracy of CRS information pertaining to the number of closed account adjustments and related dollar values.

# Comments from the Department of Defense



OFFICE OF THE UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1100

JUL 23 2002

Mr. Gregory D. Kutz  
Director, Financial Management and Assurance  
U.S. General Accounting Office  
Washington, DC 20548

Dear Mr. Kutz:

This is the Department of Defense response to the General Accounting Office (GAO) draft report GAO-02-747, "Canceled DoD Appropriations: Improvements Made but More Corrective Actions Are Needed," June 11, 2002 (GAO Code 192017). The Department appreciates the opportunity to review the draft report and provide comments.

On July 31, 2001, the Under Secretary of Defense (Comptroller) directed the Director, Defense Finance and Accounting Service (DFAS) to correct erroneous disbursement adjustments, install adequate internal controls in the Contract Reconciliation System (CRS), and implement procedures to monitor future adjustments to closed accounts. The DFAS has corrected many of the deficiencies cited in the GAO audit report. For example, improved controls in the CRS now prevent illegal cancelled funds adjustments.

The status of corrective actions for Recommendations 1 through 5 are included at the enclosure and represent significant accomplishments in correcting cited deficiencies. The DFAS Columbus personnel and the GAO auditors will continue working together until all the actions are completed.

My point of contact for this matter is Mr. Oscar Covell. He may be reached by e-mail: covello@osd.pentagon.mil or by telephone at (703) 697-6149.

Sincerely,

JoAnn R. Boutelle  
Deputy Chief Financial Officer

Enclosure

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**Appendix II**  
**Comments from the Department of Defense**

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GENERAL ACCOUNTING OFFICE (GAO) DRAFT REPORT  
JUNE 11, 2002 (GAO CODE 192017)

**"CANCELED DoD APPROPRIATIONS:  
IMPROVEMENTS MADE BUT MORE CORRECTIVE  
ACTIONS ARE NEEDED"**

**DEPARTMENT OF DEFENSE (DOD) COMMENTS  
TO THE GAO RECOMMENDATIONS**

**RECOMMENDATION 1:** The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to direct the Director of the Defense Finance and Accounting Service (DFAS) to ensure that the DFAS Columbus completes its review and correction of the remaining fiscal year (FY) 2000 illegal and otherwise improper adjustments by September 30, 2002.

**DOD RESPONSE:** On July 31, 2001, the Under Secretary of Defense (Comptroller) directed the Director, Defense Finance and Accounting Service to correct erroneous disbursement adjustments, install adequate internal controls in the Contract Reconciliation System, and implement adequate procedures to monitor future adjustments to closed accounts. The DFAS has taken the required actions. Of the \$615 million of adjustments identified by the GAO for FY 2000 as illegal or otherwise improper, \$593 million adjustments have been reversed as of June 13, 2002. The DFAS has supplied additional documentation for \$8 million of adjustments that the GAO now recognizes as proper and not requiring reversal. Supporting documentation has been supplied to the GAO for an additional \$7 million and is awaiting review and approval by the GAO Office of General Counsel. The remaining \$7 million of adjustments is under review by the DFAS and will be resolved by September 30, 2002, either through GAO approval of supporting documentation or reversal by the DFAS.

The DFAS has initiated either a full or partial reaudit of 33 contracts adversely affected by reversing adjustments. The partial reaudit of two of these contracts, including corrective actions, is complete. The remaining 31 reaudits and corresponding corrective actions will be completed by September 30, 2002.

**RECOMMENDATION 2:** The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to direct the Director of the DFAS to immediately reverse and correct closed account adjustments made during FY 2001 identified in this report as illegal or otherwise improper.

**DOD RESPONSE:** Reversing adjustments for all the FY 2001 closed account adjustments identified as illegal or otherwise improper either have been processed or are pending canceled fund approval. Many of the reversing adjustments created adverse accounting conditions for a

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large number of contracts. As a result, either a complete or partial reaudit will be necessary to determine the correct accounting for these contracts. Due to the high volume and the complexity of contracts requiring review, reaudits will be completed by September 30, 2004.

**RECOMMENDATION 3:** The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to direct the Director of the DFAS to ensure that the DFAS Columbus completes the review and correction of the additional \$1.1 billion of FY 2001 adjustments it has scheduled for detailed review.

**DOD RESPONSE:** The DFAS Reconciliation Directorate's review of \$1.1 billion FY 2001 closed account adjustments for sufficiency of supporting documentation and necessity is in process and will be completed by December 31, 2002. Reversing adjustments will be effected immediately upon identification of improper closed account adjustments. The reversing adjustments may create adverse accounting conditions for a large number of contracts. As a result, either a complete or partial reaudit may be necessary to determine the correct accounting for these contracts and will be completed by September 30, 2004.

**RECOMMENDATION 4:** The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to direct the Director of the DFAS to continue with its top-level management attention and monitoring of the program for future adjustments to closed appropriation accounts.

**DOD RESPONSE:** Top-level management will continue to pay close attention to closed account adjustments, as well as ensuring a periodic review of internal controls is performed to evaluate their adequacy. The performance standards for all Reconciliation personnel, including the Reconciliation and Contract Pay Directors, now reflect the responsibility for ensuring the propriety of canceled fund adjustments. In addition, changes have been made to the Contract Reconciliation System to identify and prevent canceled fund adjustment violations. Finally, the reconciliation matrix has been updated to include a quarterly review of canceled fund adjustments for necessity and sufficiency of supporting documentation.

**RECOMMENDATION 5:** The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to continue to monitor these adjustments to ensure that any potential Antideficiency Act violations that may occur are promptly investigated and reported as required by the Antideficiency Act, 31 U.S.C. 1351, and implementing guidance.

**DOD RESPONSE:** Corrections to charge the proper appropriation must be made irrespective of whether the correct appropriation has sufficient balances available or whether there is a potential violation of the Antideficiency Act. If an apparent violation of the Antideficiency Act occurs as a result of a correction, the applicable DoD Component is required to conduct a review and/or investigation, as applicable, in accordance with the Antideficiency Act and Volume 14, "Administrative Control of Funds and Antideficiency Act Violations," of the Department of Defense Financial Management Regulation.

Enclosure

# GAO Contact and Staff Acknowledgments

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## GAO Contact

Larry W. Logsdon, (703) 695-7510

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## Acknowledgments

Staff members who made key contributions to this report were Bertram J. Berlin, Francine M. Delvecchio, Stephen P. Donahue, Dennis B. Fauber, Jeffrey A. Jacobson, Keith E. McDaniel, and Harold P. Santarelli.

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